Change in unrealized gain (loss) on available-for-sale investments	—	—	—	—	—	—	—	—	—	(51)	—	(51)
Foreign currency translation adjustment	—	—	—	—	—	—	—	—	—	1,662	—	1,662
Net income	—	—	—	—	—	—	—	—	—	—	105,648	105,648
Total comprehensive income	—	—	—	—	—	—	—	—	—	—	—	107,259
Balance at December 31, 2003	—	$ 13,871	71,662	$ 44,346	160,866	$ 161	$ 725,219	$ (4,300)	$ (369,668)	$ 1,660	$ 191,352	$ 588,770

See accompanying notes.

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Google Inc.

CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK WARRANT AND STOCKHOLDERS' EQUITY— (Continued)
(in thousands)

	Redeemable Convertible Preferred Stock Warrant		Convertible Preferred Stock		Class A and Class B Common Stock		Additional Paid-In Capital	Notes Receivable from Officer/	Deferred Stock Based	Accumulated Other Comprehensive	Retained Earnings (Accumulated	Total Stockholders'
	Shares	Amount	Shares	Amount	Shares	Amount	Amount	Stockholders	Compensation	Income	Deficit)	Equity
Balance at December 31, 2003	—	$ 13,871	71,662	$ 44,346	160,866	$ 161	$ 725,219	$ (4,300)	$ (369,668)	$ 1,660	$ 191,352	$ 588,770
Issuance of Class A and Class B common stock upon exercise of stock options and warrants for cash and upon cashless exercise of warrants, net of unvested stock options exercised early and repurchases	—	—	—	—	4,460	4	3,801	—	—	—	—	3,805
Vesting of shares exercised early (see Note 1)	—	—	—	—	5,309	5	7,090	—	—	—	—	7,095
Issuance of Series D preferred stock upon exercise of warrant	—	(13,871)	7,437	35,514	—	—	—	—	—	—	—	35,514
Issuance of Series B preferred stock upon exercise of warrant	—	—	135	67	—	—	—	—	—	—	—	67
Issuance of fully vested common stock and fully vested stock options in connection with acquisitions	—	—	—	—	171	1	22,550	—	—	—	—	22,551
Issuance of unvested stock options in connection with acquisitions	—	—	—	—	—	—	7,069	—	(3,906)	—	—	3,163
Issuance of restricted shares to an employee in connection with an acquisition	—	—	—	—	16	—	1,538	—	(1,538)	—	—	—
Issuance of restricted												

stock units to employees	—	—	—	—	—	—	12,000	—	(12,000)	—	—	—
Issuance of common stock upon initial public offering, net of related costs of $41,001	—	—	—	—	14,142	14	1,161,066	—	—	—	—	1,161,080
Issuance of common stock in connection with Yahoo settlement	—	—	—	—	2,700	3	229,497	—	—	—	—	229,500
Tax benefits from exercise of warrants and other	—	—	—	—	—	—	191,570	—	—	—	—	191,570
Vesting of options and shares granted to non-employees	—	—	—	—	19	—	15,086	—	—	—	—	15,086
Deferred stock-based compensation related to options granted to employees	—	—	—	—	—	—	136,384	—	(136,384)	—	—	—
Amortization of deferred stock-based compensation, net of reversals for terminated employees	—	—	—	—	—	—	(10,366)	—	274,026	—	—	263,660
Conversion of convertible preferred shares to common shares	—	—	(79,234)	(79,927)	79,234	79	79,848	—	—	—	—	—
Payment of stockholder's note receivable	—	—	—	—	—	—	—	4,300	—	—	—	4,300
Comprehensive income:												
Change in unrealized gain (loss) on available-for-sale investments (net of tax effects)	—	—	—	—	—	—	—	—	—	(3,796)	—	(3,796)
Foreign currency translation adjustment (net of tax effects)	—	—	—	—	—	—	—	—	—	7,572	—	7,572
Net income	—	—	—	—	—	—	—	—	—	—	399,119	399,119
Total comprehensive income	—	—	—	—	—	—	—	—	—	—	—	402,895
Balance at December 31, 2004	—	$ —	—	$ —	266,917	$ 267	$2,582,352	$ —	$ (249,470)	$ 5,436	$ 590,471	$ 2,929,056

See accompanying notes.

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Google Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2002	2003	2004
Operating activities			
Net income	$ 99,656	$ 105,648	$ 399,119
Adjustments:			
Depreciation and amortization of property and equipment	17,815	43,851	128,523
Amortization of intangibles and warrants	11,168	11,198	19,950
In-process research and development	—	11,618	11,343
Stock-based compensation	21,635	229,361	278,746
Tax benefits from exercise of warrants and other	—	—	191,570
Non-recurring portion of settlement of disputes with Yahoo	—	—	201,000
Changes in assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(43,877)	(90,385)	(156,928)
Income taxes, net	11,517	(6,319)	(125,227)
Prepaid revenue share, expenses and other assets	(5,875)	(58,913)	(99,779)
Accounts payable	5,645	36,699	(13,516)
Accrued expenses and other liabilities	15,393	31,104	86,374
Accrued revenue share	13,100	74,603	33,872
Deferred revenue	9,088	6,980	21,997
Net cash provided by operating activities	155,265	395,445	977,044
Investing activities			
Purchases of property and equipment	(37,198)	(176,801)	(318,995)
Purchase of marketable securities	(93,061)	(316,599)	(4,134,576)
Maturities and sales of marketable securities	20,443	219,404	2,611,078
Purchases of intangible and other assets	99	—	(36,906)
Acquisitions, net of cash acquired	—	(39,958)	(21,957)
Net cash used in investing activities	(109,717)	(313,954)	(1,901,356)
Financing activities			
Proceeds from exercise of stock options, net	2,262	15,476	12,001
Proceeds from exercise of warrants	—	—	21,944
Net proceeds from initial public offering	—	—	1,161,080
Payment of note receivable from office/stockholder	—	—	4,300
Payments of principal on capital leases and equipment loans	(7,735)	(7,386)	(4,707)
Net cash provided by (used in) financing activities	(5,473)	8,090	1,194,618
Effect of exchange rate changes on cash and cash equivalents	—	1,662	7,572
Net increase in cash and cash equivalents	40,075	91,243	277,878
Cash and cash equivalents at beginning of year	17,677	57,752	148,995
Cash and cash equivalents at end of period	$ 57,752	$ 148,995	$ 426,873
Supplemental disclosures of cash flow information			
Property and equipment acquired under equipment leases	$ 7,303	$ —	$ —
Cash paid for interest	$ 2,285	$ 1,739	$ 709
Cash paid for taxes	$ 73,763	$ 247,422	$ 183,776

Issuance of redeemable convertible preferred stock warrant in conjunction with an

AdSense agreement	$ 13,871	$ —	$ —
Issuance of convertible preferred stock warrants in conjunction with capital lease arrangements	$ 199	$ —	$ —
Acquisition related activities:			
Issuance of equity in connection with acquisitions, net of deferred stock-based compensation	$ —	$ 73,540	$ 25,714

See accompanying notes.

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Summary of Significant Accounting Policies

Nature of Operations

Google Inc. ("Google" or the "Company") was incorporated in California on September 1998. The Company re incorporated in the State of Delaware in August 2003. The Company offers highly targeted advertising solutions, global Internet search solutions through its own destination Internet site and intranet solutions via an enterprise search appliance.

Basis of Consolidation

The consolidated financial statements include the accounts of Google and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated. The Company has included the results of operations of acquired entities from the date of acquisition (see Note 4).

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates.

On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable allowance, fair value of marketable securities, fair value of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, and income taxes, among others, as well as the value of common stock prior to its initial public offering for the purpose of determining stock-based compensation (see below). The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Prior to its initial public offering, the Company typically granted stock options at exercise prices equal to the values of the underlying stock as determined by its board of directors on the date of option grant. For purposes of financial accounting for stock-based compensation, management has applied hindsight within each year or quarter to arrive at reassessed values for the shares underlying these options and those issued under other transactions that are higher than the values determined by the board. These reassessed values were determined based on a number of factors, including input from advisors, the Company's historical and forecasted operating results and cash flows, and comparisons to publicly-held companies. The reassessed values were used to determine the amount of stock-based compensation recognized related to stock and stock option grants to employees and non-employees, the amount of expense related to stock warrants issued to third-parties and the purchase prices of the Company's acquisitions (see Note 4).

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Revenue Recognition

The following table presents the Company's revenues (in thousands):

	Year Ended December 31,		
	2002	2003	2004
		(in thousands)	
Advertising revenues:			
Google web sites	$306,978	$ 792,063	$1,589,032
Google Network web sites	103,937	628,600	1,554,256
Total advertising revenues	410,915	1,420,663	3,143,288
Licensing and other revenues	28,593	45,271	45,935
Revenues	$439,508	$1,465,934	$3,189,223

In the first quarter of 2000, the Company introduced its first advertising program through which it offered advertisers the ability to place text-based ads on Google web sites targeted to users' search queries. Advertisers paid the Company based on the number of times their ads were displayed on users' search results pages and the Company recognized revenue at the time these ads appeared. In the fourth quarter of 2000, the Company launched Google AdWords, an online self-service program that enables advertisers to place text-based ads on Google web sites. AdWords advertisers originally paid the Company based on the number of times their ads appeared on users' search results pages. In the first quarter of 2002, the Company began offering AdWords exclusively on a cost per click basis, so that an advertiser pays the Company only when a user clicks on one of its ads. The Company recognizes as revenue the fees charged advertisers each time a user clicks on one of the text-based ads that are displayed next to the search results on Google web sites. Effective January 1, 2004, the Company offered a single pricing structure to all of its advertisers based on the AdWords cost per click model.

Google AdSense is the program through which the Company distributes its advertisers' text-based ads for display on the web sites of the Google Network members. In accordance with Emerging Issues Task Force ("EITF") Issue No. 99 19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, the Company recognizes as revenues the fees it receives from its advertisers. This revenue is reported gross primarily because the Company is the primary obligor to its advertisers.

The Company generates fees from search services through a variety of contractual arrangements, which include per-query search fees and search service hosting fees. Revenues from set up and support fees and search service hosting fees are recognized on a straight-line basis over the term of the contract, which is the expected period during which these services will be provided. The Company's policy is to recognize revenues from per-query search fees in the period queries are made and results are delivered.

The Company provides search services pursuant to certain AdSense agreements. Management believes that search services and revenue share arrangements represent separate units of accounting pursuant to EITF 00 21 *Revenue Arrangements with Multiple Deliverables*. These separate services are provided simultaneously to the Google Network member and are recognized as revenues in the periods provided.

The Company also generates fees from the sale and license of its Search Appliance, which includes hardware, software and generally 12 to 24 months of post-contract support. As the elements are not sold separately, vendor-specific objective evidence does not exist for the allocation of revenue. As a result, the entire fee is recognized ratably over the term of the post-contract support arrangement in accordance with Statement of Position 97 2, *Software Revenue Recognition*, as amended.

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Deferred revenue is recorded when payments are received in advance of the Company's performance in the underlying agreement on the accompanying consolidated balance sheets.

Cost of Revenues

Cost of revenues consists primarily of traffic acquisition costs. Traffic acquisition costs consist of amounts ultimately paid by the Company to its Google Network members. These amounts are primarily based on revenue share arrangements under which the Company pays its Google Network members most of the fees it receives from its advertisers whose ads the Company places on those Google Network member sites. In addition, certain AdSense agreements obligate the Company to make guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. The Company amortizes guaranteed minimum revenue share prepayments (or accretes an amount payable to its Google Network member if the payment is due in arrears) based on the number of search queries or advertisements displayed on the Google Network member's web site. In addition, concurrent with the commencement of a small number of AdSense agreements, the Company has purchased certain items from, or provided other consideration to, its Google Network members. These amounts are amortized on a straight-line basis over the related term of the agreement. Traffic acquisition costs were $94.5 million, $526.5 million and $1,228.7 million in 2002, 2003 and 2004.

In addition, cost of revenues consists of the expenses associated with the operation of the Company's data centers, including depreciation, labor, energy and bandwidth costs. Cost of revenues also includes credit card and other transaction fees relating to processing customer transactions as well as expenses related to the amortization of purchased and licensed technologies.

Stock-based Compensation

Stock-based compensation consists of amortization of deferred stock-based compensation related to restricted shares, restricted stock units and options to purchase Class A and Class B common stock to employees and the values of options to purchase such stock issued to non-employees.

As permitted by Statement of Financial Accounting Standards No. 123, Accounting for Stock-based Compensation ("SFAS 123"), the Company accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations. Under APB 25, deferred compensation for options granted to employees is equal to its intrinsic value, determined as the difference between the exercise price and the reassessed value for accounting purposes of the underlying stock on the date of grant.

Prior to the initial public offering, the Company typically granted stock options at exercise prices equal to or less than the value of the underlying stock as determined by its board of directors on the date of option grant. For purposes of financial accounting, the Company has applied hindsight within each year or quarter to arrive at reassessed values for the shares underlying these options. The Company has recorded deferred stock-based compensation equal to the difference between these reassessed values and the exercise prices. After the initial public offering, the Company has generally granted options at exercise prices equal to the fair market value of the underlying stock on the date of option grant. The Company has recorded deferred stock-based compensation for these options equal to the difference between the exercise prices and the fair market values of the underlying stock on the dates of grant.

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Google Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In connection with restricted shares, restricted stock units and unvested stock options granted to employees, the Company recorded deferred stock-based compensation costs of $40.1 million, $551.4 million and $153.8 million in 2002, 2003, and 2004. The deferred stock-based compensation amounts arising from these equity activities for each of the eight three month periods ended December 31, 2004 were computed as follows:

	Three Months Ended					Three Months Ended				
	March 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003	2003 Total	March 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004	2004 Total
	(unaudited)	(unaudited)	(unaudited)	(unaudited)		(unaudited)	(unaudited)	(unaudited)	(unaudited)	
Options granted to employees	10,262,100	1,431,552	5,785,185	1,281,895	18,760,732	1,004,780	965,520	635,371	50,904	2,656,575
Weighted average exercise price	$ 0.49	$ 3.30	$ 5.17	$ 9.62		$ 16.27	$ 38.43	$ 77.86	$ 83.45	
Weighted average reassessed or fair market value of underlying stock	$ 13.09	$ 33.99	$ 52.33	$ 75.05		$ 88.13	$ 97.03	$ 85.00	$ 144.11	
Weighted average reassessed or contemporaneously determined deferred stock-based compensation per option	$ 12.60	$ 30.69	$ 47.16	$ 65.43		$ 71.86	$ 58.60	$ 7.14	$ 60.66	
Deferred stock-based compensation related to options (in millions)	$ 129.3	$ 43.9	$ 272.8	$ 83.9	$ 529.9	$ 72.2	$ 56.6	$ 4.5	$ 3.1	$ 136.4
Restricted shares granted to employees	$ —	120,000	114,999	$ —	234,999	$ —	16,175	$ —	$ —	16,175
Weighted average reassessed value of restricted shares	$ —	$ 25.96	$ 66.41	$ —		$ —	$ 95.09	$ —	$ —	
Deferred stock-based compensation related to restricted shares (in millions)	$ —	$ 3.1	$ 7.6	$ —	$ 10.7	$ —	$ 1.5	$ —	$ —	$ 1.5
Deferred stock-based compensation related to restricted stock units (in millions)	$ —	$ —	$ —	$ —		$ —	$ —	$ —	$ 12.0	$ 12.0
Deferred stock-based compensation related to option modifications (in millions)	$ —	$ —	$ —	$ 10.8	$ 10.8	$ 3.9	$ —	$ —	$ —	$ 3.9
Total deferred stock-based compensation (in millions)	$ 129.3	$ 47.0	$ 280.4	$ 94.7	$ 551.4	$ 76.1	$ 58.1	$ 4.5	$ 15.1	$ 153.8

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The above table does not include options granted at exercise prices equal to the fair market value of the underlying stock at the time of, and subsequent to, the initial public offering. Also, it does not include options granted at exercise prices in excess of the reassessed values of the underlying stock prior to the initial public offering. These options were granted with no intrinsic value and, accordingly, no deferred stock-based compensation has been recorded. Also, the above table does not include restricted shares that were issued in connection with certain business acquisitions nor does it include shares that were fully vested at date of grant.

Net amortization of deferred stock-based compensation totaled $20.2 million, $213.5 million and $263.7 million in 2002, 2003 and 2004. The deferred stock-based compensation is being amortized using the accelerated vesting method, in accordance with SFAS 123, EITF 96 18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in connection with Selling, Goods or Services* ("EITF 96 18"), and Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 28, over the vesting period of each respective restricted share, restricted stock unit and stock option, generally over four or five years. The remaining unamortized, deferred stock-based compensation for all restricted shares, restricted stock units and stock option grants through December 31, 2004 will be expensed as follows over each of the next five years and thereafter (in millions) assuming all employees remain employed at Google for their remaining vesting periods and before consideration of the additional stock-based compensation the Company expects to recognize related to these stock options beginning July 1, 2005 under Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R") (for additional discussion regarding this pronouncement, see below under Effect of a Recent Accounting Pronouncement):

	(unaudited)
2005	$ 145.8
2006	70.5
2007	25.9
2008	5.6
2009	1.3
Thereafter	0.4
	$ 249.5

The Company accounts for stock awards issued to non-employees in accordance with the provisions of SFAS 123 and EITF 96 18. Under SFAS 123 and EITF 96 18, the Company uses the Black-Scholes method to measure the value of options granted to nonemployees at each vesting date to determine the appropriate charge to stock-based compensation.

The Company recorded stock-based compensation expense of $1.5 million, $15.8 million and $15.0 million for the value of stock options earned by non-employees in 2002, 2003 and 2004.

At December 31, 2004, there were 302,950 unvested options to purchase shares of Class B common stock held by nonemployees with a weighted-average exercise price of $0.52 and a weighted-average 36 month remaining vesting period. These options generally vest on a monthly and ratable basis. No options that vest over time were granted to non-employees in the year ended December 31, 2004.

Pro forma information regarding net income has been determined as if the Company had accounted for its employee stock options under the method prescribed by SFAS 123. The resulting effect on pro forma net income disclosed is not representative of the effects on net income on a pro forma basis in future years. For discussion regarding the anticipated effects of SFAS 123R on the Company's operating results, see below under Effect of a Recent Accounting Pronouncement.

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Had compensation cost for options granted under the option plans (see Note 10) been determined based on the fair value method prescribed by SFAS 123, the Company's net income and net income per share would have been adjusted to the pro forma amounts below (in thousands, except per share data):

	Year Ended December 31,		
	2002	2003	2004
Net income, as reported	$ 99,656	$ 105,648	$ 399,119
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	20,175	213,545	171,380
Deduct: Total stock-based employee compensation expense under the fair value based method for all awards, net of related tax effects	(22,390)	(215,946)	(186,138)
Net income, pro forma	$ 97,441	$ 103,247	$ 384,361
Net income per share:			
As reported—basic	$ 0.86	$ 0.77	$ 2.07
Pro forma—basic	$ 0.85	$ 0.75	$ 1.99
As reported—diluted	$ 0.45	$ 0.41	$ 1.46
Pro forma—diluted	$ 0.44	$ 0.40	$ 1.41

For purposes of the above pro forma calculation, the value of each option granted through December 31, 2004 was estimated on the date of grant using the Black-Scholes pricing model with the following weighted-average assumptions:

	Year Ended December 31,		
	2002	2003	2004
Risk-free interest rate	3.34%	2.11%	2.77%
Expected volatility	75%	75%	69%
Expected life (in years)	3	3	3
Dividend yield	—	—	—

The weighted-average fair value of an option granted in 2002, 2003 and 2004, was $2.79, $29.12, and $63.27, using the Black-Scholes pricing model.

Stock Options Exercised Early

The Company typically allows employees to exercise options prior to vesting. Upon the exercise of an option prior to vesting, the exercising optionee is required to enter into a restricted stock purchase agreement with the Company, which provides that the Company has a right to repurchase the shares purchased upon exercise of the option at the original exercise price; provided, however, that its right to repurchase these shares will lapse in accordance with the vesting schedule included in the optionee's option agreement. In accordance with EITF 00 23, *Issues Related to Accounting for Stock Compensation under APB Opinion No. 25 and FASB Interpretation No. 44*, stock options granted or modified after March 21, 2002, which are subsequently exercised for cash prior to vesting are treated differently from prior grants and related exercises. The consideration received for an exercise of an option granted after the effective date of this guidance is considered to be a deposit of the exercise price and the related dollar amount is recorded as a liability. The shares and liability are only reclassified into equity on a ratable basis as the award vests. The Company has applied this guidance and recorded a liability on the consolidated balance sheets relating to 11,987,482 and 7,605,222 of options granted subsequent to March 21, 2002 that were exercised and are unvested at December 31, 2003 and 2004. Furthermore, these shares are not presented as outstanding on the accompanying consolidated statements of

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

redeemable convertible preferred stock warrant and stockholders' equity and consolidated balance sheets. Instead, these shares are disclosed as outstanding options in the footnotes to these financial statements.

Net Income per Share

The Company computes net income per share in accordance with SFAS 128, Earnings per Share. Under the provisions of SFAS 128, basic net income per share is computed using the weighted average number of Class A and Class B common shares outstanding during the period except that it does not include unvested Class A and Class B common shares subject to repurchase or cancellation. Diluted net income per share is computed using the weighted average number of Class A and Class B common shares and, if dilutive, potential Class A and Class B common shares outstanding during the period. Potential Class A and Class B common shares consist of the incremental Class A and Class B common shares issuable upon the exercise of stock options, warrants, unvested common shares subject to repurchase or cancellation and convertible preferred stock. The dilutive effect of outstanding stock options and warrants is reflected in diluted earnings per share by application of the treasury stock method. Convertible preferred stock is reflected on an if converted basis.

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Year Ended December 31,		
	2002	2003	2004
Basic and diluted net income per share:			
Numerator:			
Net income	$ 99,656	$105,648	$399,119
Denominator:			
Weighted average Class A and Class B common shares outstanding	143,317	168,093	210,877
Less: Weighted average unvested Class A and Class B common shares subject to repurchase or cancellation	(28,075)	(30,396)	(17,701)
Denominator for basic calculation	115,242	137,697	193,176
Effect of dilutive securities			
Add:			
Weighted average convertible preferred shares	70,432	71,128	47,584
Weighted average stock options and warrants, restricted stock units and unvested Class A and Class B common shares subject to repurchase or cancellation	34,959	47,813	32,021
Denominator for diluted calculation	220,633	256,638	272,781
Net income per share, basic	$ 0.86	$ 0.77	$ 2.07
Net income per share, diluted	$ 0.45	$ 0.41	$ 1.46

Certain Risks and Concentrations

The Company's revenues are principally derived from online advertising, the market for which is highly competitive and rapidly changing. Significant changes in this industry or changes in customer buying behavior could adversely affect the Company's operating results.

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash equivalents, marketable securities and accounts receivable. Cash equivalents consist of money market funds, agency notes and municipal bonds. Marketable securities consist primarily of agency notes, market auction preferred securities, municipal auction rate receipts and municipal bonds held with four financial institutions. Accounts receivable are typically unsecured and are derived from revenues earned from customers primarily located in the U.S. In 2003 and 2004, the Company generated approximately 71% and 66% of its revenues from customers based in the U.S. with the majority of customers outside of the U.S. located in Japan and Europe. Many of the Company's Network members are in the Internet industry. To appropriately manage this risk, the Company performs ongoing evaluations of customer credit and limits the amount of credit extended, but generally no collateral is required. The Company maintains reserves for estimated credit losses and these losses have generally been within management's expectations.

Advertising and other revenues generated from America Online, Inc., which is also a stockholder, accounted for 15%, 16% and 12% of revenues, primarily through the Company's AdSense program, in 2002, 2003 and 2004. No other Google Network member generated greater than 10% of revenues in these periods.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, marketable securities, accounts receivable, accounts payable and accrued liabilities, approximate fair value because of their short maturities. The carrying amounts of the Company's equipment loans and capital leases approximate fair value of these obligations based upon management's best estimates of interest rates that would be available for similar debt obligations at December 31, 2003 and 2004.

Cash and Cash Equivalents and Marketable Securities

The Company invests its excess cash in money market funds and in highly liquid debt instruments of U.S. corporations, municipalities and U.S. government and its agencies. All highly liquid investments with stated maturities of three months or less from date of purchase are classified as cash equivalents; all highly liquid investments with stated maturities of greater than three months are classified as marketable securities.

Management determines the appropriate classification of its investments in debt and marketable equity securities at the time of purchase and reevaluates such designation at each balance sheet date. The Company's debt and marketable equity securities have been classified and accounted for as available for sale. The Company may or may not hold securities with stated maturities greater than twelve months until maturity. In response to changes in the availability of and the yield on alternative investments as well as liquidity requirements, the Company occasionally sells these securities prior to their stated maturities. As these securities are viewed by the Company as available to support current operations, based on the provisions of ARB No. 43, Chapter 3A, Working Capital-Current Assets and Liabilities, equity and debt securities with maturities beyond 12 months (such as the Company's auction rate securities) are classified as current assets in the accompanying balance sheet. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of stockholders' equity. Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of interest income or expense.

Accounts Receivable

Accounts receivable are recorded at the invoiced amount and are non-interest bearing. The Company maintains an allowance for doubtful accounts to reserve for potentially uncollectible receivables. Management

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reviews the accounts receivable by amounts due by customers which are past due to identify specific customers with known disputes or collectibility issues. In determining the amount of the reserve, management makes judgments about the creditworthiness of significant customers based on ongoing credit evaluations. The Company also maintains a sales allowance to reserve for potential credits issued to customers. The amount of the reserve is determined based on historical credits issued.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally two to five years. Equipment under capital leases and leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the assets. Construction in process is primarily related to the building of production equipment servers and lease-hold improvements. Depreciation for these assets commences once they are placed in service.

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The Company reviews property and equipment and certain identifiable intangibles, excluding goodwill, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amounts to the future undiscounted cash flows the assets are expected to generate. If property and equipment and certain identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the asset exceeds its fair market value. The Company has made no adjustments to its long-lived assets in any of the years presented.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company tests its goodwill for impairment at least annually or more frequently if events or changes in circumstances indicate that this asset may be impaired. The Company found no impairment in any of the years presented. The tests were based on the Company's single operating segment and reporting unit structure.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment whenever events or changes in circumstances indicate an asset's carrying value may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. The Company is currently amortizing its acquired intangible assets with definite lives over periods ranging from one to four years. The Company believes no events or changes in circumstances have occurred that would require an impairment test for these assets.

Income Taxes

The Company recognizes income taxes under the liability method. Deferred income taxes are recognized for differences between the financial reporting and tax bases of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

Foreign Currency

Generally, the functional currency of the Company's international subsidiaries is the local currency. The financial statements of these subsidiaries are translated to U.S. dollars using month-end rates of exchange for

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assets and liabilities, and average rates of exchange for revenues, costs and expenses. Translation gains and losses are deferred and recorded in accumulated other comprehensive income as a component of stockholders' equity. The Company recorded $1.7 million and $7.6 million of net translation gains in 2003 and 2004. There was no translation gain or loss in 2002. Net gains and losses resulting from foreign exchange transactions are included in the consolidated income statements. The Company recognized $2.1 million of net gains and $6.7 million of net losses resulting from foreign exchange transactions in 2003 and 2004. Net transaction gains and losses recognized during 2002 were not material.

Derivative Financial Instruments

The Company enters into forward foreign exchange contracts with financial institutions to reduce the risk that its cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. This program is not designed for trading or speculative purposes. No foreign currency hedge transactions were entered into prior to 2004.

In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the Company recognizes derivative instruments as either assets or liabilities on the balance sheet at fair value. These forward exchange contracts are not accounted for as hedges and, therefore, changes in the fair value of these instruments are recorded as interest income (expense) and other, net. Neither the cost nor the fair value of these forward foreign exchange contracts was material at December 31, 2004. The notional principal of forward foreign exchange contracts to purchase U.S. dollars with Euros was $231.0 million at December 31, 2004. There were no other forward foreign exchange contracts outstanding at December 31, 2004.

Promotional and Advertising Expenses

The Company expenses promotional and advertising costs in the period in which they are incurred. For the years ended December 31, 2002, 2003 and 2004 promotional and advertising expenses totaled approximately $5.6 million, $20.9 million and $37.7 million.

Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on foreign exchange and unrealized gains and losses on available for sale investments. The differences between total comprehensive income and net income as disclosed on the consolidated statement of redeemable convertible preferred stock warrant and stockholders' equity for 2002, 2003 and 2004 were insignificant.

Effect of a Recent Accounting Pronouncement

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004) ("SFAS 123R"), *Share-Based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method under Accounting Principles Board Opinion No. 25 ("APB 25"), *Accounting for Stock Issued to Employees*, and generally would require instead that such transactions be accounted for using a fair-value-based method. SFAS 123R requires the use of an option pricing model for estimating fair value, which is amortized to expense over the service periods. The requirements of SFAS 123R will be adopted beginning July 1, 2005.

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

If the Company had adopted the provisions of SFAS 123 in 2004, net income would have been reduced by approximately $14.8 million (as shown above). The additional stock-based compensation, net of income taxes that would have been recognized under SFAS 123 in 2004 is a function of the generally insignificant differences between the intrinsic values of stock options granted prior to the initial public offering and the related fair values on the dates of grant determined using the Black-Scholes method. This additional stock-based compensation, net of income taxes is substantially less than the additional amount that will be recognized after adoption of SFAS 123R compared to that which would have been recognized under APB 25. After the initial public offering, the Company began to grant stock options with generally no intrinsic value and expects to continue to do so in the foreseeable future. As the fair values of these options on the dates of grant are and will be significantly greater than the related intrinsic values, the Company will recognize significantly greater stock-based compensation after the adoption of SFAS 123R than it would have if it continued to apply APB 25, and significantly greater than the additional stock-based compensation, net of income taxes it would have recognized under SFAS 123 in 2004. The stock-based compensation the Company will recognize after the adoption of SFAS 123R will also be affected by the number and type of stock-based awards granted in the future and the pricing model and related assumptions used for estimating the fair values of options.

The provision for income taxes includes a reduction for disqualifying dispositions on incentive stock options using the portfolio rather than the individual award method. The portfolio method was used because it was more practicable to do so. SFAS 123R requires the use of the individual award method. If the Company had used the individual award method, its net income would have been reduced further than the approximate $14.8 million reduction in net income noted above if the Company had adopted the provisions of SFAS 123.

SFAS 123R allows for either prospective recognition of compensation expense or retrospective recognition, which may be back to the original issuance of SFAS 123 or only to interim periods in the year of adoption. The Company is currently evaluating these transition methods.

Finally, SFAS 123R requires that cash inflows from financing activities on the Company's statement of cash flows include the cash retained as a result of the tax deductibility of increases in the value of equity instruments issued under share-based payment arrangements in excess of any related stock-based compensation recognizable for financial reporting purposes. These tax benefits shall be determined based on the individual award method. In addition, cash outflows from operating activities must include the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based arrangements had not been deductible in determining taxable income in excess of any related stock-based compensation recognizable for financial reporting purposes. The above amounts are the same. This cash benefit has been included in the determination of cash provided by operating activities on the Company's statement of cash flows in 2004. The change in methods will likely have a significant negative effect on the Company's cash provided by operating activities in periods after adoption of SFAS 123R.

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 2. Cash, Cash Equivalents and Marketable Securities

Cash, cash equivalents and marketable securities consist of the following (in thousands):

	As of December 31,	
	2003	2004
Cash and cash equivalents	$148,995	$ 426,873
Marketable securities:		
Municipal securities	166,538	1,616,684
U.S. government notes	11,185	5,163
U.S. corporate securities	8,000	83,577
Total marketable securities	185,723	1,705,424
Total cash, cash equivalents and marketable securities	$334,718	$2,132,297

The Company has not experienced any significant realized gains or losses on its investments in the periods presented. Gross unrealized losses were $6.4 million at December 31, 2004 primarily related to municipal securities and were not material at December 31, 2003.

The following table summarizes the estimated fair value of the Company's securities held in marketable securities classified by the stated maturity date of the security (in thousands):

	As of December 31,	
	2003	2004
Due within 1 year	$ 29,381	$ 340,771
Due within 1 year through 5 years	81,830	853,604
Due within 5 years through 10 years	11,382	65,017
Due after 10 years	63,130	446,032
Total marketable securities	$185,723	$1,705,424

In addition, at December 31, 2003 and December 31, 2004, the Company had $11.0 million and $11.1 million of restricted cash and investment securities classified as other current assets which are included in "prepaid revenue share, expenses and other assets" in the accompanying consolidated balance sheets.

Note 3. Interest Income (Expense) and Other

	Year Ended December 31,		
	2002	2003	2004
		(in thousands)	
Interest income	$ 1,215	$ 2,663	$15,996
Interest expense	(2,570)	(1,931)	(862)
Other	(196)	3,458	(5,092)
Interest income (expense) and other, net	$(1,551)	$ 4,190	$10,042

Note 4. Acquisitions

Business Combinations

During the year ended December 31, 2004, the Company acquired all of the voting interests of four companies. Three of the companies were accounted for as business combinations. Because the fourth company was considered a development stage enterprise, the transaction was accounted for as an asset purchase in